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U.S. Balance of International Payments

BY FRANK WHITSON FETTER

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U. S. Balance of International Payments

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with the aid of the Research Staff of the Foreign Policy Association

INTRODUCTION

THE years 1933, 1934 and 1935 have witnessed several striking developments in the balance of international payments of the United States. In these years the excess of commodity exports over imports was 225 million, 478 million and 234 million dollars, respectively[1]—as compared with an export surplus averaging over 3 billion dollars annually in the period 1915-1921 and over 750 million dollars in the period 1922-1929. The export surplus in both 1933 and 1935 was less than in any other year since 1910.

In 1934 and 1935 gold and silver imports were greater than in any other years of our history.[2] Gold imports totaled nearly 3 billion dollars—more (even when adjustment is made for change in the gold content of the dollar) than the total increase in the gold stocks of the United States between the outbreak of the World War and the end of 1921, and greater than the subsequent increase between 1922 and Britain's abandonment of the gold standard in September 1931. In 1933, 1934 and 1935 the net silver imports were valued at 41 million, 86 million and 337 million dollars, respectively, in contrast with the normal situation when the country, as one of the world's leading silver producers, is a net exporter.[3] War debt payments, which before 1931 had been in excess of 200 million dollars a year, stopped completely after June 1934 with the exception of Finland's payments, totaling about $357,000 annually, and some small payments on account by Greece.

The Roosevelt administration's program for tariff reduction through reciprocal trade agreements, which got under way in 1934 when an agreement was signed with Cuba, made rapid progress in 1935 and early 1936 with the negotiation of twelve new agreements, including such important countries as France, Canada, the Netherlands, Sweden and Switzerland. It is expected that agreements with several more countries will be announced in the course of the present year. The prospects for a larger volume of international trade, both exports and imports, are much more favorable than in the first year of the Roosevelt administration, when the N.R.A., A.A.A., and monetary devaluation were considered the keys to recovery.[4]

These developments affect our economic life in many ways, but all have a marked influence on the make-up of our balance of international payments. This report describes the various items in the balance of payments, surveys the historical development of the American balance of payments up to the coming of the world depression, and seeks to explain the changes which have taken place since 1929 as well as their significance for the country's future international position.

ITEMS IN A BALANCE OF INTERNATIONAL PAYMENTS

Whenever a person in the United States exports goods, he creates a claim against some one in a

1. Except where otherwise indicated, all statistics on the United States balance of payments in this report are taken from the summary table for 1919-1934 on pp. 70-71 of "The Balance of International Payments of the United States in 1934," *Trade Information Bulletin No. 826*, published by the Department of Commerce. This table is reproduced on page 57 of this report, with the additions of the 1935 figures from the Department of Commerce release, *New York Times*, May 4, 1936.

2. For comparative figures on commodity, silver and gold movements for 1926-1935, cf. *New York Times*, January 23, 1936.

3. In only six previous years in the past half century (1921, 1922, 1923, 1924, 1931 and 1932) had imports exceeded exports. In most of these years the import surplus was small, as evidenced by the fact that the combined imports in these six years were considerably less in dollar value than the net imports in 1934 alone.

4. For a discussion of the general principles of the trade agreements program and the terms of the Cuban, Brazilian, Belgian and Haitian agreements, cf. David H. Popper, "Progress of American Tariff Bargaining," *Foreign Policy Reports*, May 22, 1935. For a more recent discussion, strongly defending the trade agreement program, cf. F. B. Sayre, *America Must Act* (New York and Boston, World Peace Foundation, 1936).

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foreign country; every time he purchases goods outside the United States, he incurs an obligation to pay some one abroad—that is, some one abroad creates a claim against him. If economic relations between Americans and foreigners[5] consisted merely in the buying and selling of goods, giving rise to such claims and counterclaims, exports and imports would pay for each other and equal each other in value, except as payment might be made in specie. But in the modern world a great many other international transactions create claims and counterclaims, and have effects identical with those of the movement of commodities and specie.

These transactions, other than the movement of commodities and specie, which give rise to claims and counterclaims, are commonly referred to as "invisible" exports or "invisible" imports. For example, if an American purchases silks from France to the amount of $500, some one in France acquires American money with which American goods may be bought and exported. If an American had gone to France and spent francs for which he had paid $500, no goods would have entered the United States; but out of the proceeds of this tourist's outlay for such things as railroad fare, hotel bills, taxicabs and admissions to art galleries, the French would be in a position to purchase $500 worth of goods in the United States. These expenditures by the American tourist constitute an invisible import of the United States and an invisible export of France. For purposes of international finance, the art galleries of France, the pyramids of Egypt, the Scottish lakes and the graves in Westminster Abbey create "exports" from their countries which, although "invisible," are just as effective as the shipment of commodities. Other important "invisibles" are payments made for ocean shipping, insurance and banking commissions, royalties on books and moving pictures, interest on foreign investments and gifts to persons or institutions in foreign countries. The movie royalties of over 50 million dollars a year paid by foreigners to American companies are just as much an export from this country as a shipment of wheat; when an American church gives a hundred thousand dollars for missionary work in China or John Peterson sends $100 to his aged mother in Stockholm, the result is the same as if Americans had imported goods of equal value: *viz.,* it gives foreigners the means of paying for American goods. All these "invisibles" represent payment for some service rendered or are in the nature of gifts, and are commonly referred to as service or current items.

International lending and borrowing, and the repayment of debts, are also an important source of invisible exports and imports. When an American exports a million dollars in goods, that gives him, or any one to whom he transfers his claim, the ability to import a million dollars in goods. If the same American borrows abroad a million dollars (or its equivalent in foreign currency), it gives him the ability to buy foreign goods just as effectively as the export of commodities, but with this very important difference: in the case of the loan he would have to pay interest, and to repay the loan at some later date. Interest payments and repayment of principal would, in turn, be an invisible export for the creditor country. In any period, the total exports and imports, both visible and invisible, are equal, but the question whether this equality is the result of current items and repayment of debt, or of lending and borrowing operations, is of great consequence for the balance of payments at a subsequent period.[6]

PRE-WAR BALANCE OF PAYMENTS OF THE UNITED STATES[7]

In every year since 1875, with the exception of 1888 and 1893, commodity exports from this country have exceeded commodity imports. For the eighteen years preceding the outbreak of the World War this excess of exports averaged nearly

5. As regards the effect on the balance of payments, it makes no difference whether goods are imported into the United States by American citizens or foreigners resident here, or whether the residents of the United States who travel abroad are American citizens or foreigners. To simplify discussion in this report, however, the term *Americans* is used to include those resident in the United States; the term *foreigners* to include those resident abroad, regardless of nationality.

6. For further details, cf. p. 62.

7. For the pre-war period there are no annual studies of the American balance of payments such as have been made since 1919. The best study for any single year (fiscal year 1909-1910) was made by Sir George Paish, *The Trade Balance of the United States,* published as one of the Reports of the National Monetary Commission (Senate Document No. 579, 61st Congress, 2d Session). Those interested in a more detailed survey of the American balance of payments before 1919 should consult "The Balance of Trade of the United States," by C. J. Bullock, J. H. Williams and R. S. Tucker, in *The Review of Economic Statistics,* July 1919, pp. 215-39, and republished in part in F. W. Taussig, *Selected Readings in International Trade and Tariff Problems* (Boston, Ginn, 1921), pp. 159-206. It is from this survey that statistics in the report on the American balance of payments before 1919 are taken, except where otherwise indicated.

In 1934 George Peek, Special Adviser to the President on Foreign Trade, made a study of the American balance of payments from 1896 to 1933, and his figures agree approximately with those of Bullock, Williams and Tucker. *Letter to the President on Foreign Trade* (Washington, Government Printing Office, 1934); *Letter to the President on International Credits for Foreign Trade and Other Purposes, 1896-1933* (Washington, Government Printing Office, 1934). These two letters were reprinted by The Chemical Foundation of New York City in a pamphlet entitled *Remember, O Stranger, Arithmetic is the first of the sciences and the mother of safety.* All citations of the Peek letters refer to this reprint.

$500,000,000 a year. What was the situation which made it possible or, more accurately speaking, necessary for this country in the pre-war period to ship abroad a half-billion dollars in goods for which no goods were obtained in return?

At the outbreak of the World War the United States was a debtor nation to the extent of about 3 billion dollars—that is, foreign investments in this country were greater than American investments abroad by this amount. It is estimated that of the half-billion-dollar export surplus approximately $160,000,000 represented interest and dividends paid to foreigners on this investment; about $175,000,000 represented the expenses of American tourists abroad; $150,000,000 to $175,000,000 the remittances that foreign immigrants resident in this country made to friends and relatives in "the old country"; and about $35,000,000 payments to foreign shipping concerns. Net gold imports averaged slightly less than $10,000,000 a year for the period. An increase in foreign investments in this country in the pre-war years—considerably greater than the increase in American investment abroad—made possible these invisible imports and gold imports somewhat in excess of our surplus of commodity exports.

BALANCE OF PAYMENTS OF THE UNITED STATES, 1896-1914*

(Annual Average of Net Balances in Millions of Dollars)

Exports	
Excess of commodity exports	487
Increase in net foreign investment in the United States	55

Imports	
Shipping and freight services	34
Tourist expenditures	175
Immigrant remittances and contributions	160
Interest and dividends on net foreign investment in the United States	160
Excess of gold imports	10
Miscellaneous, and errors and omissions	3

* Fiscal years, July 1-June 30. This table is based, with slight adaptations, on the material in Bullock, Williams and Tucker, "The Balance of Trade in the United States," cited. It does not differ in its essentials from the picture of the pre-war balance of payments given in Peek, cited.

WARTIME DEVELOPMENTS IN OUR BALANCE OF PAYMENTS

The opening months of the World War caused serious disturbances in this country's international trade, with the cutting-off of important export markets. But once the early uncertainties had passed and the Allies had realized that the war would be long-drawn-out, American international trade and finance took a new turn. The Allies were in pressing need of supplies and munitions—a need far greater than could be satisfied by the dollar exchange created by their exports and earnings on American investments. In order to pay for these supplies, the Allied countries—particularly Britain—shipped large amounts of gold to this country and re-sold many securities to Americans. In 1915 the French and British governments arranged through the House of Morgan for a loan of $500,000,000, and subsequently secured further advances in the same way. American banks also extended large credits. Commodity exports, which had slumped in the latter months of 1914 and the early part of 1915, reached unprecedented levels in the second half of 1915 and in 1916, and despite a sharp increase in imports our export surplus from July 1915 to December 1916 was over 4 billion dollars.[8] With our entrance into the war the private financing of Allied purchases in this country virtually ceased, as did the import of gold; but loans amounting to about 10 billion dollars were extended by the American government to the Allies between April 1927 and the early part of 1920.

It may be doubted whether any country ever experienced so great a change in its international economic position within so short a period as did the United States in the years between the outbreak of the World War and the end of 1919. Our excess of commodity exports was over 15 billion dollars—greater than the export surplus in the preceding 40 years. This export surplus was paid for by gold imports of nearly a billion dollars, the liquidation of much of the foreign investment in this country, remittances in connection with European relief, and loans abroad by the American government and banks and private investors of approximately 15 billion dollars. In addition to war debts of about 10 billion dollars, we were at the end of 1919 a net creditor of the world on private account.[9]

8. Previous to July 1915, American foreign trade statistics were reported on the basis of a July 1-June 30 fiscal year. In 1916 and thereafter they have been reported on a calendar year basis.

THE BALANCE OF INTERNATIONAL PAYMENTS OF THE UNITED STATES, 1919-1935

(*In millions of dollars*)

Item	*1919*	*1920*	*1921*	*1922*	*1923*	*1924*	*1925*	*1926*	*1927*	*1928*	*1929*	*1930*	*1931*	*1932*	*1933*	*1934*	*1935*
COMMODITY AND SERVICE ITEMS																	
Merchandise trade (as reported):																	
Exports (credit)	7,920	8,228	4,485	3,832	4,167	4,591	4,910	4,809	4,865	5,128	5,241	3,843	2,424	1,612	1,675	2,133	2,282
Imports (debit)	3,904	5,278	2,509	3,113	3,792	3,610	4,227	4,431	4,184	4,091	4,400	3,061	2,090	1,323	1,450	1,655	2,048
Balance	+4,016	+2,950	+1,976	+719	+375	+981	+683	+378	+681	+1,037	+841	+782	+334	+289	+225	+478	+234
Shipping and freight services:																	
By Americans to foreigners (credit)	510	203	90	71	65	76	75	127	140	147	206	155	117	73	49	61	62
By foreigners to Americans (debit)	437	110	57	64	73	68	83	188	206	227	272	251	189	118	65	96	102
Balance	+73	+93	+33	+7	−8	+8	−8	−61	−66	−80	−66	−96	−72	−45	−16	−35	−40
Tourist expenditures:																	
By foreigners in United States (credit)	......	......	......	60	100	100	100	142	153	163	183	160	112	71	71	94	129
By Americans abroad (debit)	......	......	......	360	500	600	660	640	681	715	821	762	568	446	292	314	393
Balance	−50	−150	−200	−300	−400	−500	−560	−498	−528	−552	−638	−602	−456	−375	−221	−220	−264
Immigrant remittances, charity, etc.:																	
By foreigners to United States (credit)	......	......	......	......	60	......	......	35	35	25	24	33	10	6	3	5	......
By Americans to abroad (debit)	......	......	......	......	420	......	......	299	290	301	289	248	212	169	135	129	......
Balance	−600	−700	−500	−400	−360	−355	−360	−264	−255	−276	−265	−215	−202	−163	−132	−124	−115
Interest and dividends:																	
Paid by foreigners to United States investors (credit)	150	150	180	350	400	455	520	735	800	893	979	916	662	461	487	453	426
Paid to foreigners investing in United States (debit)	100	100	100	125	150	150	165	268	281	359	414	300	126	68	103	126	140
Balance	+50	+50	+80	+225	+250	+305	+355	+467	+519	+534	+565	+616	+536	+393	+384	+327	+286
War-debt receipts	+243	+53	+87	+157	+258	+182	+187	+195	+206	+207	+207	+241	+113	+99	+20	+1	......
Government transactions:																	
Expenses and remittances by foreign governments in United States (credit)	30	4	3	13	......	......	......	46	57	53	60	46	34	31	32	39	......
Expenses and remittances by United States Government abroad (debit)	867	122	54	29	19	5	5	89	86	110	152	127	134	101	85	68	......
Balance	−837	−118	−51	−16	−19	−5	−5	−43	−29	−57	−92	−81	−100	−70	−53	−29	......
Miscellaneous commodity and service items (net)	+170	+26	−11	+58	+71	+96	+94	−18	+21	−88	−105	−16	+7	+3	+8	+68	+46
Balance on commodity and service account	+3,065	+2,204	+1,414	+450	+167	+712	+386	+156	+507	+725	+447	+629	+160	+131	+215	+466	+147
GOLD AND CURRENCY MOVEMENTS																	
Net gold movements	+160	−50	−686	−235	−295	−216	+102	−72	+154	+272	−120	−278	+176	−11	+173	−1,217	−1,739
Silver movements[2]	......	......	......	......	......	......	......	......	......	......	......	......	......	......	......	−86	−336
Net currency movements	+90	+100	−100	......	+50	−50	−60	−40	−55	−40	−15	+20	−10	−80	−90	−48	−1
Balance, gold, silver, and currency movements	+250	+50	−786	−235	−245	−266	+42	−112	+99	+232	−135	−258	+166	−91	+83	−1,351	−2,076
CAPITAL MOVEMENTS																	
Private long-term capital movement:																	
Credit	515	571	303	294	435	364	551	1,326	1,609	2,591	2,328	2,161	1,520	862	1,505	1,160	1,964
Debit	891	1,400	974	1,011	434	966	1,038	1,928	2,332	3,253	2,464	2,428	1,301	645	1,456	958	1,522
Balance	−376	−829	−671	−717	+1	−602	−487	−602	−723	−662	−137	−267	+219	+217	+49	+202	+442
Government capital account	−1,781	−240	−86	......	......	......	......	......	......	......	......	......	......	......	......	......	......
Net short-term capital movement	......	......	......	+375	+3	+216	−61	+350	+900	−188	−80	−485	−709	−409	−385	+184	+1,085[3]
Balance on capital account	−2,157	−1,069	−757	−342	+4	−386	−548	−252	+177	−850	−217	−752	−490	−192	−336	+386	+1,527
Residual item	−1,158	−1,185	+129	+127	+74	−60	+120	+208	−783	−107	−95	+381	+164	+152	+38	+499	+402

[1]Figures for 1919-1934 are a reproduction of table in *Balance of Payments, 1934*, pp. 70-71; figures for 1935 are from Department of Commerce release, *New York Times*, May 4, 1936.

[2]Prior to 1934, silver movements were included in merchandise adjustments, which is one of the items under the heading "Miscellaneous Commodity and Service Items."

[3]In 1935 there is included in this item a number of miscellaneous capital transactions, involving a total net credit of $115,000,000.

BALANCE OF PAYMENTS OF THE UNITED STATES, JULY 1, 1914-DECEMBER 31, 1919*

(Annual Average of Net Balances, in Millions of Dollars; Net Balances for Period, in Millions of Dollars, given in brackets†)

Exports			Imports		
Excess of commodity exports	2,877	[15,824]	Shipping and freight services	38	[206]
Earnings on net private investment abroad	27	[150]	Capital movement: (increase in American investment abroad; decrease in foreign investment in United States)	707	[3,896]
War debt receipts	91	[503]	Immigrant remittances	218	[1,200]
Exports of paper currency	30	[166]	Loans to foreign governments by United States	1,721	[9,466]
Net miscellaneous, and errors and omissions in estimates	149	[824]	Foreign expenditures by United States government	337	[1,855]
			Excess of gold imports	153	[844]

* Data for 1914-1918 from J. H. Williams, "The Balance of International Payments for the Year 1920," *The Review of Economic Statistics,* Vol. III, p. 201; data for 1919 from annual Balance of Payments studies (see table, p. 57), which are the figures of Williams, cited, p. 200, slightly changed on basis of revised estimates by Department of Commerce.

† Figures are given in annual averages in order that the table be on the same basis as other tables in this report. However, because of great changes from year to year in the importance of some items, especially government transactions, annual averages do not give so good a picture of the situation in this period as do totals for the period. These latter figures are given in brackets.

BALANCE OF PAYMENTS, 1920-1929

Our post-war position apparently called for a very much smaller excess of exports than before the war, or even for an excess of commodity imports.[10] No such import surplus has appeared up to the present time, and in the years 1920-1929 the total excess of commodity exports was over 10 billion dollars. When the development which took place between 1920 and 1929 in the fields of foreign lending, foreign travel, and immigrant remittances is considered, this continued excess of commodity exports is not surprising.

9. Any estimate of America's net creditor position on private account at the end of 1919 is subject to a large margin of error, but it is probable that the figure was somewhere between 2 and 4 billion dollars. Frank Vanderlip and J. H. Williams placed our creditor position on private account at that time at $2,350,000,000, but apparently short-term banking credits were not included in this estimate. "The Future of Our Foreign Trade," Supplement to Vol. II, *The Review of Economic Statistics,* pp. 18-19. Ralph A. Young, in a study prepared for the National Industrial Conference Board (New York, 1929), *The International Economic Position of the United States,* estimated our net creditor position at 14 billion dollars in 1919. A deduction of the war debts would have made our net creditor position on private account slightly under 4 billion dollars (pp. 48, 49).

10. Bullock, Williams and Tucker, writing in 1919, said, "Our imports must increase, our excess of exports disappear; and it may be . . . that an excess of imports will take its place." "The Balance of Trade of the United States," cited, p. 200.

Professor Taussig, writing in the same year, said in more cautious vein: "Looking over the ten years from 1920 to 1930 the outlook is for some continuing excess of merchandise exports over merchandise imports. But it would seem impossible that the annual excess should be on the average at all so great as that of the decades preceding the War. In the end—supposing no new factors to enter before this final stage is reached—the accumulation of interest payments will bring about an excess of imports." *Selected Readings,* cited, p. 216.

With economic distress in many parts of Europe after the Armistice, and a condition of relative prosperity in the United States, foreigners resident in the United States, as well as American citizens and charitable and religious organizations, made contributions abroad to their families or in support of relief work. These remittances, which had averaged less than $200,000,000 a year before 1914, amounted to $600,000,000 in 1919, and in 1920 reached an all time high of $700,000,000. Although they declined within a few years to about $250,000,000, these remittances in the 10-year period 1920-1929 totaled nearly 4 billion dollars.

Prosperity in this country in the 1920's, and the desire of Americans to visit the battlefields of France, led to an annual summer exodus of tourists to Europe. The rise of the automobile stimulated trips to Canada. For some Americans, prohibition made foreign travel particularly attractive. In the 10-year period 1920-1929 expenditures abroad by American tourists were nearly 4.5 billion dollars more than the expenditures of foreign tourists in this country. Net gold imports for the period were over a billion dollars, so that these invisible items, together with gold shipments, came within about a billion dollars of our commodity export surplus.

But in this same 10-year period the total of interest payments on American private investment abroad was in excess of 3 billion dollars, and total payments on account of war debts (interest and principal) were over 1.5 billion dollars. Some minor items will help to explain how receipt of these large payments was possible under the cir-

cumstances, but the key to the situation lies in the fact that from 1920 on great sums were loaned abroad by American investors, thus putting in the hands of foreigners the dollar exchange with which payments were made to other American investors and to the national government. Foreign bonds in excess of 8 billion dollars were floated in this country between 1920 and 1929. In addition, large direct investments were made abroad by Americans in mines, plantations and branch factories. This long-term investment abroad was partially offset by foreign investment in American securities and American industry, so that in the 1920's net lending abroad on long-term account was slightly in excess of 5 billion dollars. At the end of 1929, in addition to 11 billion dollars of war debts, the United States was a net creditor of the world on long-term account by about 10 billion dollars.[11]

In connection with this rise of the United States as a great lending nation, Americans, and in particular New York banks, came to owe increasing amounts to foreigners, payable either on demand or on short notice. This was in part a result of the great lending abroad on long-term account, for the borrowers generally left part of the proceeds temporarily on deposit in New York. The flow of foreign funds into the New York stock market after 1926 to take advantage of high interest rates on stock market loans, and the keeping of reserve balances in New York in connection with widespread adoption of the gold exchange standard, also contributed to a substantial increase in the short-term debtor position of the United States between 1922 and 1929. At the end of 1929 we were a net debtor on short-term account by about $1,600,000,000.[12]

BALANCE OF PAYMENTS OF THE UNITED STATES, 1920-1929*
(Annual Average of Net Balances in Millions of Dollars)

Exports		Imports	
Excess of commodity exports	1,062	Shipping and freight services	15
Interest and dividends	335	Tourist expenditures	433
War debt receipts	174	Immigrant remittances, charity, etc.	374
Miscellaneous commodity and service items	14	Government transactions	44
Short-term capital movement	151	Gold imports	116
		Currency imports	21
		Private long-term capital movements†	576
		Errors and omissions in estimates	157

* Based on data in annual Balance of Payments studies, as given in table on p. 57.

† In the years 1920 and 1921, loans totaling $326,000,000 were made by the American government to foreign governments. These transactions have been included in this table under the private long-term capital movements.

RELATION OF AMERICAN TARIFF POLICY TO BALANCE OF PAYMENTS IN THE 1920'S

With the return of the Republican party to power in 1921, the country rejected the policy of moderate protective duties which had been embodied in the Underwood tariff of 1913. The Emergency Tariff Act of 1921 was followed by the Fordney-McCumber Act of 1922, providing for a general increase in duties. Many economists at that time attacked this tariff program as incompatible with our new position as a creditor nation, pointing out that creditor countries which hoped to receive interest payments and be repaid should encourage, not discourage, imports. But under the conditions which actually developed after 1922, the charge that the Fordney-McCumber Act prevented the adjustment in our commodity trade which would have permitted foreigners to pay their debts (both private obligations and war debts) can be accepted only with major reservations. As long as Americans traveled abroad so extensively, Americans and foreigners resident in the United States were so generous in their gifts, and American bankers arranged loans to foreign governments and foreign corporations on so extensive a scale, there was no need for foreign debtors to build up export surpluses (i.e., an import surplus for the United States) to pay their debts. In fact, it would have been impossible for an import surplus to have arisen in the United States, even under free trade, so long as Americans were furnishing foreigners

11. The Department of Commerce, in *Balance of Payments, 1929*, pp. 30-31, estimated total American investments abroad on January 1, 1930 at between $13,366,000,000 and $15,368,000,000. Foreign long-term investment in this country was estimated at about 5 billion dollars. The Commerce Department estimated American direct investments abroad at the end of 1929 at $7,477,735. "American Direct Investments in Foreign Countries," *Trade Information Bulletin No. 731*, p. 8. Dr. Max Winkler's estimate of American investments abroad at the end of 1929 was somewhat higher—$16,604,052,000 ("America's Stake Abroad," *F. P. A. Information Service*, February 24, 1931, p. 456).

12. Cf. *Balance of Payments, 1929*, pp. 56-59.

with such large supplies of dollar exchange from other sources. It was only after American foreign lending slackened in 1928 that the American tariff became a direct obstacle to the solvency of this country's debtors.

In a less obvious but very important way, however, the Fordney-McCumber tariff disturbed our relations with debtor countries. American tariff policy of the 1920's injured the prosperity of many of our debtors by closing profitable markets and thus preventing importation from the United States, without new loans, of the commodities desired by the people of those countries. So far as this encouraged foreign governments to borrow abroad instead of raising the necessary funds by taxation, the Fordney-McCumber tariff created an unstable equilibrium in our balance of payments, and prevented foreigners from paying their debts in that decade.

BALANCE OF PAYMENTS IN THE DEPRESSION: 1930-1933

In the first year of the depression the outstanding development in our balance of payments was extensive withdrawal of short-term balances from the United States. War debt payments were maintained, no publicly issued foreign dollar securities went into default, and the net receipts on account of interest and dividends on our foreign investments and war debts reached an all time high of over 850 million dollars. New long-term lending abroad, which had declined greatly in 1929 when the stock market boom had boosted interest rates in this country, was greater in 1930 than in 1929. In conjunction with the withdrawal of short-term balances, this resulted in the greatest increase in the net creditor position of the United States of any year since 1921, with the exception of 1928. The excess of exports over imports—$782,000,000—was the third largest since 1921.

In the three subsequent years—1931, 1932, 1933—the great reduction in war debt payments, the widespread default on publicly issued foreign dollar bonds, the decline of earnings on direct investments, and the freezing of balances through exchange control in foreign countries, cut deeply into our invisible exports. New long-term foreign investment declined greatly in 1931, and became virtually nil in 1932 and 1933—the total for these three years being less than for any previous year in the post-war period. But the continued withdrawal of short-term balances was on so extensive a scale that, despite considerable foreign buying of American securities and repurchase of foreign dollar bonds at bargain-counter prices, the net capital movement out of the United States, constituting an invisible import, was greater in the 4-year period 1930-1933 than in the years 1925-1929. Hence there is no mystery about the continuation of the export surplus in the first four years of the depression period.[13]

NET BALANCE OF PAYMENTS OF THE UNITED STATES, 1930-1933*
(Annual Average of Net Balances in Millions of Dollars)

Exports		Imports	
Excess of commodity exports	408	Shipping and freight services	57
Interest and dividends	482	Tourist expenditures	414
War debt receipts	118	Immigrant remittances, charity, etc.	178
Gold movement	15	Government transactions	76
Private long-term capital movements	55	Currency movement	40
Errors and omissions in estimates	184	Short-term capital movement	497

* Based on data in annual Balance of Payments studies, as given in table on p. 57.

The Hawley-Smoot Tariff Act, which became effective on June 17, 1930, substantially increased duties on many products. Since 1922, American tariff rates had been very high, although for reasons already indicated these high duties were not so much of an obstacle to adjustment in our balance of payments as is sometimes believed. But when foreign lending by this country slowed down after 1928 and more especially after 1930, thus drying up the source of dollar exchange which had helped to pay interest to American holders of foreign bonds and finance an export surplus of commodities, the high American tariffs became a serious obstacle to adjustment. Pressure for default on American-owned obligations of foreign governments and foreign corporations was increased by restrictions on the import of goods. Countries

13. In these years large gold exports occurred several times, particularly after Britain's suspension of gold payments—in September 1931, in the summer of 1932, and in the early months of 1933. But counterflows reduced the net annual movement to relatively small figures, and for the 4-year period the net export was only $60,000,000.

which did not default found it necessary sharply to curtail imports in order to maintain payments. Where a more liberal American tariff would have facilitated an adjustment through an increase of exports to the United States, American tariff policy made adjustment possible only by default or by a reduction in American imports and an even greater reduction in American exports.[14]

THE BALANCE OF PAYMENTS IN 1934 AND 1935

The years 1934 and 1935 brought several significant changes in our balance of payments: a cessation of the withdrawal of short-term funds, which by the end of 1933 had been reduced to about the minimum working balances required by foreign banks; new foreign investments in this country, both in the form of increased short-term balances and purchase of securities in the American market; and a great import of gold and silver, totaling over 3 billion dollars.

The inflow of gold began shortly after the passage of the Gold Reserve Act in January 1934. The gold movement in the months immediately following was due largely to the *de facto* stabilization of the dollar at 59 per cent of its former gold content. In 1935 imports were due rather to the economic and political situation in Europe—in particular uncertainty as to the maintenance of the gold standard in France and other gold bloc countries and fears of a general European war as a result of the Italo-Ethiopian situation. It is this gold import which has been in part responsible for the great increase in the excess reserves of the member banks of the Federal Reserve System, which reached $3,312,000,000 on December 11, 1935.[15] The existence of these excess reserves has driven down interest rates, and is a potent force making for credit expansion and inflation of commodity prices. The imports of gold were largely on private account, but the silver imports were almost all the result of government purchases under the Silver Purchase Act of June 19, 1934.[16] These purchases of silver abroad, like the imports of gold, gave foreigners the means of paying for large amounts of American goods, and helped to make possible the export balances in 1934 and 1935. The gold imports were associated with the flow of funds to this country, but it is noteworthy that in these two years gold imports were more than a billion dollars in excess of the calculated net capital movement to the United States. They were even greater than the net capital movement would be if all of the residual item of $900,000,000 were assigned to capital movement. Had silver been counted as a commodity, in 1935 we would have had an import surplus of commodities for the first time since 1893.

BALANCE OF PAYMENTS OF THE UNITED STATES, 1934-1935*
(Annual Average of Net Balances in Millions of Dollars)

Exports		Imports	
Excess of commodity exports	356	Shipping and freight services	38
Interest and dividends	307	Tourist expenditures	242
Miscellaneous commodity and service items†	43	Immigrant remittances, charity, etc.	120
Private long-term capital movement	322	Gold imports	1,478
Short-term capital movement	635	Silver imports	211
Errors and omissions in estimates	451	Currency imports	25

* Based on data in annual Balance of Payments studies, as given in table on p. 57.

† The Department of Commerce summary for 1935 does not give a separate item for government transactions, and hence in this table, government transactions for 1934 are included under "Miscellaneous Commodity and Service Items."

Expenditures abroad by American tourists increased in both 1934 and 1935, but the proportionate increase in expenditures by foreign tourists in this country was even greater—a situation probably due in part to the devaluation of the dollar. A striking feature of these years was the further decline, in the face of improved economic conditions in the United States, of immigrant remittances. In 1935 these fell to $92,000,000—the first time since the Balance of Payments studies were started that this item has been under $100,000,000.

14. Only special features in our short-term credit situation, and in the movement of gold and silver, avoided a much more drastic adjustment of exports in relation to imports in the years 1930-1935.

15. *Federal Reserve Bulletin,* January 1936, p. 16. By excess reserves are meant the legal reserves (consisting of deposits with the Federal Reserve Banks) in excess of the reserves required by law.

16. For a detailed study of the present silver situation, cf. a forthcoming issue of *Foreign Policy Reports* by John Parke Young.

SIGNIFICANCE OF ADJUSTMENT IN BALANCE OF PAYMENTS

In international trade and finance, claims of Americans against foreigners can be met only by equal claims of foreigners against Americans. Every export item involves an import item,[17] and an American can receive interest on a foreign investment—an invisible export—only when an import is created.

Although in this narrow sense a balance of international payments is always in adjustment, the manner in which the adjustment takes place, as well as the current creditor or debtor position of the country, is of great importance for the future. A country may pay for its commodity and service imports and meet its foreign obligations by borrowing, or by commodity exports or service items. As far as the immediate effects on the balance of payments are concerned, both types of settlement are the same. But where payments are made out of fresh borrowing, this immediate adjustment leaves a disturbing heritage for the balance of payments at some future time. Similarly, fresh lending by a creditor country keeps its balance of payments temporarily in adjustment without the necessity of a change in the commodity trade or in service items. When lending to foreigners ceases, that method of "adjustment" is ended. Except as current invisible imports enter into the picture, commodity imports must exceed exports in creditor countries, and commodity exports must exceed imports in debtor countries, if interest is to be paid by the foreign debtors and commitments for the repayment of principal are to be met. There is always, however, the possibility that under such conditions foreign debtors will simply default on their obligations, thus making the "adjustment" by wiping out the claims of the creditor.

FUTURE OF UNITED STATES BALANCE OF PAYMENTS

In the light of these considerations, the question for the future is not whether the American balance of payments will adjust to the country's new international position, but in what way is the necessary adjustment in our balance of payments to take place?

The heart of this problem is the fate of existing American investment abroad. The resumption of service on defaulted bond issues, and further payments on war debts, would greatly increase our invisible exports and the need for adjustment in other items; still further defaults on our foreign investments might reduce to negligible quantities our net invisible exports from dividends, interest and capital transactions.

In 1934 net receipts of interest and dividends on international account were slightly over $325,000,000, and receipts from war debts less than one million; in 1935 net receipts of interest and dividends were $286,000,000. With an improvement in world economic conditions, this item is likely to increase; the loosening of severe foreign exchange restrictions now in effect in many countries, the increase in earnings from direct investment abroad, the resumption of service, even in part, on the many foreign dollar loans now in default,[19] are all developments which would make for larger invisible exports for the United States, calling for larger imports (either visible or invisible), or a decrease in exports. It would be reckless, however, to prophesy how large this item will be and hence how much of an adjustment will be called for in other items in our balance of payments. The payments which Americans may expect to receive on account of foreign investments are not independently fixed amounts; they will be influenced greatly by this country's tariff and loan policies, and the habits of the American public in coming decades.

The simplest method of "adjustment" to the new position of the United States as a creditor nation would be the loss of our foreign investments through default on bond issues, and the wiping-out of direct investments through economic depression abroad. Only in a Pickwickian sense could such a development be called an "adjustment" to our new position of creditor nation, but it is within the realm of possibility.[20]

17. The "residual item" in the annual Department of Commerce Balance of Payments studies is simply the result of the inability to estimate exactly all the current invisibles and credit transactions, of smuggling, and of incorrect valuations placed on commodity exports and imports. A large "residual item" is generally considered as evidence that capital transactions for the year were not correctly estimated.

19. The Institute of International Finance reports that on December 31, 1935 $2,055,079,740 of publicly issued foreign dollar bonds were in complete default, and $754,812,600 were in partial default. On the basis of the Institute's estimate that about 60 per cent of the outstanding foreign dollar bonds are held in the United States, this would place the American holdings of issues in complete default at about $1,200,000,000, and of issues in partial default at about $450,000,000. "Statistical Analysis of Foreign Dollar Bond Defaults," *Bulletin No. 85*, April 6, 1936.

20. George Peek, in a *Letter to the President on Foreign Trade and International Investment Position of the United States as of December 31, 1934* (Washington, Government Printing Office, 1935), presented figures giving the United States a much smaller net creditor position than had been indicated by earlier Department of Commerce studies. Leaving out war debts, he placed our creditor position at $6,594,000,000, and suggested that a revaluation of our direct investments abroad on the basis of present market values would make this

Renewal of foreign lending by this country would for a time permit an adjustment, as was the case in the 1920's, by the creation of resulting "imports" which would take care of interest on existing foreign investment. This would be no permanent solution and, when the lending stopped, would leave an even greater problem of adjustment.

The same is to be said of imports of gold and silver. It was the specie imports of 1934 and 1935 which made possible our export balance of commodities in those years. But the existing stocks of gold and silver and the new supplies coming from the mines are not great enough to permit long continuance of specie imports on the scale of the last two years.

Current invisible imports of shipping services, and particularly of tourist expenditures and immigrant remittances, constitute a permanent means of large payments on account of foreign investment. In every year of the Balance of Payments studies (1919-1935), these invisible imports have been greater than net interest and dividend payments, plus war debt receipts. Even with commodity exports continuing in excess of commodity imports—but by a smaller margin than before—these invisibles could make adjustment to our creditor position possible on the basis of interest and dividend receipts of the last few years. But a resumption of service on any considerable part of the loans now in default, and the transfer back to this country of materially increased earnings on direct investments abroad, would call for more American exchange than is available at the present time from these current invisible imports.

The future of the shipping service item will depend largely on the policy of this and other governments with regard to shipping subsidies. In the absence of substantial subsidies, American merchant ships are at a disadvantage as compared with the ships of countries with lower operating expenses and cheaper construction costs. If we reduce the existing subsidy to American shipping, our payments to foreign shipping (an invisible import) might increase substantially; if the subsidy were raised, the American merchant marine might even increase to the point where our receipts from shipping services were in excess of our expenditures, as was true in the early post-war period (1919-1922).[21]

Our net expenditures on foreign travel are greatly influenced by the vagaries of fashion, both here and abroad. The extent and nature of international trade in commodities is largely determined by relative prices in the various trading countries. It is these price differences which explain why American automobiles, cotton, machinery and pork products are sold abroad, why sugar, fine china and textiles are imported into the United States, even in the face of high tariffs. Similarly, differences in cost of living and travel have some influence on the tourist trade, but this influence is less than that of prices on the commodity trade. The decision whether the summer vacation of the school teacher will be spent in France or Maine, or whether the New York executive will seek relief from January weather and business worries on the golf links of Florida or Bermuda, although not independent of prices, is very greatly affected in most cases by habit, by the desire to do what is currently fashionable, or by the prospects of wars and revolutions. The same general considerations apply to travel by foreigners in America. There is no physical barrier to an increase in our net tourist expenditures to a figure surpassing that of the 1920's. But in view of the circumstances connected with American travel abroad in the post-war decade, the international political situation, and the growth of recreational facilities in the United States, it seems improbable that our net tourist expenditures will soon regain the importance they had before 1930.

Although the future of our invisible imports in shipping services and tourist expenses is uncertain, there is much evidence that immigrant remittances and contributions will be of less importance in coming years. In the 1920's the net amount of remittances decreased almost steadily, with only a slight pick-up in 1928 and 1929. American churches have been reducing their expenditures in the foreign mission field. With the policy of permanent limitation of immigration, the proportion of the American population remitting funds to families in the "old country" seems certain to decrease. In 1934 and 1935 immigrant remittances were only about two-thirds of what they had been before the World War.

lower. Samuel Crowther, in a sensational popularization of Peek's conclusions, suggests that we are now a debtor nation. *$970,000,000 minus, A Second Primer* (New York, The Chemical Foundation, 1935), p. 31 and *passim.*

It is likely that Peek's estimates of foreign investment in this country—$7,590,000,000—are too high. But even granting the correctness of this figure, both Peek and Crowther are in a vicious circle of their own creation when they claim that we have nearly lost our creditor position, or even are a debtor nation, and then from that conclude that there is no need for the United States to lower tariffs to facilitate the receipt of payments on our foreign investment. Our high tariffs, by making more difficult the acquisition of dollar exchange, encourage defaults and help to reduce our net creditor position.

21. For a discussion of some of the problems of subsidies, cf. John C. deWilde, "Ship Subsidies and the Future of World Shipping," *Foreign Policy Reports,* March 14, 1934.

The greatest possibility of adjustment lies in the commodity trade through a change in the relation of exports and imports. Such an adjustment, although greatly aided by low tariffs in the creditor nation, is possible even with high tariffs, providing exports from the creditor country are cut down sufficiently. The extent, however, to which adjustment in the commodity trade is a practical possibility, and the effect of that adjustment on debtor and creditor country will differ greatly under a policy of extreme protection and a policy of moderate duties. The virtual closing of the American market to many foreign goods which can be produced more advantageously abroad than in this country has a depressing effect on economic conditions abroad, reducing both the taxes necessary to make payments on public debts, and the business profits necessary to make payments on private debts. Where, by a reduction of exports by the creditor, debtors continue to pay in the face of the obstacles of high tariffs, the effect on the creditor may prove very disturbing since the burden of adjustment is placed on the export industries.[22] With an expanding volume of international trade, an adjustment of a few hundred million dollars in the relation of exports and imports is a small matter, absorbed with little disturbance to the economic life of the country. The attempt to make a similar adjustment on a sharply declining volume of trade, even if successful, will place an unnecessary burden on the debtor nation and cause needless disturbance in the economic life of the creditor nation.[23]

An increase in our imports relative to our exports will be caused primarily by an increase in the price that foreigners can receive for goods in the American market over the price that Americans can receive abroad. In view of our international economic position, a slightly higher price level here than abroad is desirable. At the present time the excess reserves of the American banks make possible a very substantial increase in American prices. But as long as we remain on the existing *de facto* gold standard by permitting the free export of gold, and do not have import duties at prohibitive levels, any strong inflationary movement here would meet two checks: the increased import of foreign goods seeking the higher prices in the American market; and an outward flow of gold restricting the expansion of credit. Hence, it is important that the public take an intelligent attitude toward the increase of imports and the outflow of gold which seem likely to accompany any considerable upward movement of American prices. In the light of the political history of American tariff controversy, we may expect even a temporary reversal in our commodity trade balance to be met by the cries of high protectionists, picturing a "flood" of alien goods "inundating" the American public and prophesying the ruin of America by the "pauper" and "sweated" labor of Europe. General support of such views might halt the present program for tariff reduction through trade agreements and even lead to concerted pressure on Congress for increases in tariffs. An inflow of goods is both a check on inflation of prices and a means of facilitating an adjustment in our balance of payments which will preserve as much as possible of our foreign investment and will at the same time expand foreign markets for American agriculture and industry.

No matter what happens, the American balance of payments will adjust in one way or another. But the United States, through its tariff policy, has an important voice in deciding how that adjustment will take place. We can adjust on a smaller volume of international trade by continuation of existing default on foreign investment, by new defaults, by a further shrinkage of our exports, and by depriving the public of many foreign goods. We can adjust on a larger volume of international trade with salvaging of much of our foreign investment, the expansion of export markets, and a higher standard of living as a result of a larger and more varied supply of foreign goods. A high tariff will foster the first type of adjustment, a low tariff the second.

22. For a discussion of the effects of American tariff policy in putting the burden of international adjustment on American agriculture by a restriction of foreign markets, cf. Secretary Henry A. Wallace, "America Must Choose," *World Affairs Pamphlet* (New York, Foreign Policy Association and World Peace Foundation, 1934).

23. These same considerations apply even if freight, tourist expenditures and remittances should be large enough to meet all payments on our foreign indebtedness and American commodity exports continue permanently in excess of commodity imports. In either case, some adjustment in the relation of commodity exports and imports, from the situation prevailing up to 1930, will be necessary.